WC 05-41

Please Date Stamp And Return

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January 28, 2005

VIA COURIER

Marlene H. Dortch, Secretary
Federal Communications Commission
Wireline Competition Bureau – CPD – 214 Appls.
P.O. Box 358145
Pittsburgh, PA 15251-5145

FCC/MELLON JAN 2 8 2005

Re: Application of Computer Network Technology Corporation and McDATA Corporationn For Section 214 Authority to Transfer Control of an Authorized International Carrier

Dear Ms. Dortch:

On behalf of Computer Network Technology Corporation and McDATA Corporation (collectively "Applicants"), enclosed please find an original and six (6) copies of an application for Section 214 authority to transfer control of domestic and international authorizations from Computer Network Technology Corporation to McDATA Corporation.

Also enclosed is a completed Fee Remittance Form 159 and a check in the amount of $895.00 which satisfies the filing fee required for this Application.

Pursuant to Section 63.04(b) of the Commission's rules, Applicants submit this filing as a combined international section 214 transfer of control application and domestic section 214 transfer of control application ("Combined Application"). Applicants have filed the Combined Application with the International Bureau through the MyIBFS Filing System.

Please direct any questions regarding this filing to the undersigned.

Respectfully submitted,

William B. Wilhelm, Jr.
Brian McDermott

Counsel for Applicants

Enclosure

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of the Joint Application of **Computer Network Technology Corporation** and **McDATA Corporation** Request For Grant of Authority Pursuant to Section 214 of the Communications Act of 1934, as amended, and Sections 63.04 and 63.24 of the Commission's Rules to Complete a Transfer of Control of Computer Network Technology Corporation, an Authorized International and Domestic Interstate Carrier	File No. ITC-T/C-2005 ______ WC Docket No. 05-__________

JOINT APPLICATION

I. INTRODUCTION

A. Summary of Transaction

Computer Network Technology Corporation ("CNT") and McDATA Corporation ("McDATA") (collectively, "Applicants"), pursuant to Section 214 of the Communications Act, as amended, 47 U.S.C.A. § 214, and Sections 63.04 and 63.24 of the Commission's rules, 47 C.F.R. §§ 63.04 & 63.24, notify the Commission and respectfully request authority to complete a series of transactions which will result in a transfer of control of Computer Network Technology Corporation.

B. Application Eligible for Streamlined Processing

Applicants respectfully submit that this Application is eligible for streamlined processing pursuant to Sections 63.03 and 63.12 of the Commission's Rules, 47 C.F.R. §§ 63.03 & 63.12. With respect to domestic authority, this Application is eligible for streamlined processing pursuant to Section 63.03(b)(2)(i) because, immediately following the transactions, (1) Applicants and their affiliates (as defined in Section 3(1) of the Communications Act – "Affiliates") combined will hold less than a ten percent (10%) share of the interstate, interexchange market; (2) Applicants and their Affiliates will provide local exchange service only in areas served by dominant local exchange carriers (none of which are parties to the proposed transactions) and; (3) none of the Applicants or their Affiliates are dominant with respect to any service. With respect to international authority, this Application is eligible for streamlined processing pursuant to Section 63.12(a)-(b) of the Commission's Rules, 47 C.F.R. §63.12(a)-(b). In particular, Section 63.12(c)(1) is inapplicable because none of the Applicants are foreign carriers, or are affiliated with any foreign carriers and none of the scenarios outlined in Section 63.12(c) of the Commission's Rules, 47 C.F.R. § 63.12(c), apply.

In support of this Application, Applicants provide the following information:

II. THE APPLICANTS

A. Computer Network Technology Corporation (" CNT")

CNT is a corporation organized under the laws of the state of Minnesota. CNT's address is: Computer Network Technology Corporation, 6000 Nathan Lane North, Minneapolis, Minnesota 55442. CNT is publicly traded on the Nasdaq National Market System under the symbol "CMNT". CNT holds authority to provide global facilities-based and resold services pursuant to authority granted by the Commission in File No. ITC-214-

20030807-0413, effective October 6, 2003. *See* Public Notice Report No. TEL-00720; DA 03-3128, released October 9, 2003. After the consummation of the transaction, CNT will retain its authorization and will continue to provide services to its customers. Additional information on CNT is available on the company's website at: http://www.cnt.com and is incorporated herein by reference.

B. McDATA Corporation ("McDATA")

McDATA is a Delaware corporation with principal offices located at 380 Interlocken Crescent, Bloomfield, Colorado 80021. McDATA is publicly traded on the Nasdaq National Market System. McDATA's Class A common shares are traded under the symbol "MCDTA" and its Class B common shares are traded under the symbol "MCDT". Neither McDATA nor any of its subsidiaries currently have any licenses relating to the provision of telecommunications services. McDATA's revenue from the twelve months ending January 31, 2004 was $418.9 million and for the quarter ending October 31, 2005 was $98.5 million. Attached as Exhibit B are the most recent 10-K and 10-Q of McDATA that demonstrate that McDATA is financially qualified to acquire control of CNT. Also attached as Exhibit C are the management biographies of McDATA's key operational personal that demonstrate McDATA's managerial qualifications to acquire control of CNT. Additional information on McDATA is available on the company's website at: http://www.mcdata.com.

In order to effect the merger, McDATA has created Condor Acquisition, Inc. ("Condor") as a newly formed wholly owned subsidiary that was established to effect the merger of CNT. Condor is a Minnesota corporation with its principal offices located at 380 Interlocken Crescent, Broomfield, Colorado 80021. Condor is not authorized to provide telecommunication services in any state.

III. DESCRIPTION OF THE TRANSACTIONS

Applicants have entered into an Agreement and Plan of Merger dated as of January 17, 2005 ("Merger Agreement")[1] through which (1) Condor will be merged with and into CNT whereupon the separate existence of Condor shall cease and CNT will be the surviving corporation ("Surviving Corporation") and (2) outstanding shares of CNT will be converted into the right to receive 1.3 shares of McDATA Class A Common Stock plus cash in lieu of franctional shares and the Surviving Corporation will become a wholly owned subsidiary of McDATA. Upon completion of the transaction, current McDATA and CNT stockholders will own approximately 76% and 24%, respectively, of McDATA. In light of the structure of the proposed Transaction, Applicants seek approval for the transfer of control of CNT to McDATA. Attached as Exhibit A is an illustrative chart describing the proposed Transaction.

Following the consummation of the Transaction, CNT's customers will continue to receive service under the same rates, terms and conditions of service as before. CNT will become a wholly owned subsidiary of McDATA, will continue to operate and provide services to CNT's customers and will retain the assets used in the provisions of those services. As a result, the Transaction will be virtually transparent to CNT's customers in terms of the services they receive.

IV. PUBLIC INTEREST STATEMENT

Applicants respectfully submit that the proposed Transaction serves the public interest. In particular, Applicants submit that (1) the Transaction will increase competition in the telecommunications market by reinforcing the status of CNT as a viable competitor and (2) the

Transaction will minimize the disruption of service and be virtually transparent to CNT' s customers.

The proposed Transaction is expected to facilitate competition by improving the operational position of both CNT and McDATA. The combination of CNT's and McDATA's complementary products and services will provide customers with the long-term confidence that their strategic requirements for a storage networking infrastructure needed for increased productivity, business continuity and regulatory compliance will be met. Moreover, given that the Transaction will not affect CNT' s rates, terms and conditions of services, the Transaction will have no negative effects on customers.

V. INFORMATION REQUIRED BY SECTION 63.24(e)

Pursuant to Section 63.24(e)(3) of the Commission's rules, the Applicants submit the following information requested in paragraphs (a) through (d) of Section 63.18, for CNT and McDATA, and also submit the information requested in paragraphs (h) through (p) of Section 63.18 for McDATA:

63.18 (a) Name, address and telephone number of each Applicant:

Transferee:
McDATA Corporation ("McDATA")
380 Interlocken Crescent
Bloomfield, Colorado 80021
(720) 558-8000 (Tel)

Licensee:
Computer Network Technology Corporation ("CNT")
6000 Nathan Lane North
Minneapolis, MN 55442
(763) 268-6000 (Tel)

Licensee is a publicly traded company so no individual Transferor exists.

[1] A copy of the Merger Agreement will be provided upon request.

63.18 (b) Jurisdiction of Organizations:

Transferee:

McDATA is a corporation organized and existing under the laws of the State of Delaware.

Licensees:

CNT is a corporation organized and existing under the laws of the State of Minnesota.

63.18 (c) Correspondence concerning this Application should be sent to:

William B. Wilhelm, Jr.
Brian McDermott
Swidler Berlin LLP
3000 K Street NW
Suite 300
Washington, DC 20007
(202) 424-7500 (Tel)
(202) 424-7645 (Fax)
WBWilhelm@swidlaw.com (E-Mail)
BMMcDermott@swidlaw.com (E-Mail)

63.18 (d) Neither McDATA nor any of its subsidiaries have any licenses relating to the provision of telecommunications services.

CNT is authorized to provide facilities-based and resold international services pursuant to Section 214 authority granted in FCC File No. ITC-214-20030807-0413. CNT also holds blanket domestic Section 214 authority.

63.18 (h) McDATA is publicly traded on the Nasdaq National Market System. McDATA's Class A common shares are traded under the symbol "MCDTA" and its Class B common shares are traded under the symbol "MCDT".

Following the transactions, to the best of McDATA's knowledge no person or entities will directly or indirectly own ten percent (10%) or more of the equity of McDATA. As a result, McData following the proposed Transaction will be the only entity that directly or indirectly owns or controls more than 10% of CNT.

To the best of McDATA's knowledge, there are no officers or directors of McDATA that also serve as an officer or director of a foreign carrier as defined in Section 63.09(d).

63.18 (i) McDATA certifies that it is not a foreign carrier, nor is it affiliated with a foreign carrier, nor will McDATA be affiliated with a foreign carrier as a result of this transaction.

63.18 (j) McDATA certifies that it does not seek to provide international telecommunications services to any destination country where:

(1) McDATA is a foreign carrier in that country; or
(2) McDATA controls a foreign carrier in that country; or
(3) Any entity that owns more than 25 percent of McDATA, controls a foreign carrier in that country; or
(4) Two or more foreign carriers (or parties that control foreign carriers) own, in the aggregate more than 25 percent of McDATA and are parties to, or the beneficiaries of, a contractual relation affecting the provision or marketing or international basic telecommunications services in the United States.

63.18 (k) Not applicable.

63.18 (l) Not applicable.

63.18 (m) Not applicable.

63.18 (n) McDATA certifies that it has not agreed to accept special concessions directly or indirectly from any foreign carrier with respect to any U.S. international route where the foreign carrier possesses market power on the foreign end of the route and will not enter into such agreements in the future.

63.18 (o) Applicants certify that they are not subject to denial of federal benefits pursuant to Section 5301 of the Anti-Drug Abuse Act of 1998. *See* 21 U.S.C. § 853a. *See also* 47 C.F.R. §§ 1.2001-1.2003.

63.18 (p) Applicants respectfully submit that this Application is eligible for streamlined processing pursuant to Section 63.12(a)-(b) of the Commission's Rules, 47 C.F.R. §63.12(a)-(b). In particular, Section 63.12(c)(1) is inapplicable because none of the Applicants are or are affiliated with any foreign carriers and none of the scenarios outlined in Section 63.12(c) of the Commission's Rules, 47 C.F.R. § 63.12(c), apply.

VI. INFORMATION REQUIRED BY SECTION 63.04

In lieu of an attachment, pursuant to Commission rule 63.04(b), 47 C.F.R. § 63.04(b) Applicants submit the following information in support of their request for domestic Section 214 authority in order to address the requirements set forth in Commission Rule 63.04(a)(6)-(12):

(a)(6) A description of the proposed Transactions is set forth in **Section III** above.

(a)(7) CNT provides interstate domestic telecommunications services throughout the United States. CNT also offers intrastate telecommunications services in Alabama, Arizona, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming and the District of Columbia. CNT has pending request for intrastate authorization in Alaska, Arkansas, California, Georgia, Maine, Pennsylvania and Virginia.

McDATA does not provide telecommunications services in any area.

Neither McDATA nor CNT is affiliated, as that term is defined in Section 3(1) of the Communications Act of 1934, as amended, with any other U.S. domestic common carrier not listed above.

(a)(8) Applicants respectfully submit that this Application is eligible for streamlined processing pursuant to Sections 63.03 of the Commission's Rules, 47 C.F.R. §63.03. In particular, with respect to domestic authority, this Application is eligible for streamlined processing pursuant to Section 63.03(b)(2)(i) because, immediately following the transactions, (1) Applicants and their affiliates (as defined in Section 3(1) of the Communications Act – "Affiliates") combined will hold less than a ten percent (10%) share of the interstate, interexchange market; (2) Applicants and their Affiliates will provide local exchange service only in areas served by dominant local exchange carriers (none of which are parties to the proposed transactions) and; (3) none of the Applicants or their Affiliates are dominant with respect to any service.

(a)(9) Through this Application, Applicants seek authority with respect to both international and domestic Section 214 authorizations (this Application is being separately and concurrently filed with respect to both types of authorities in compliance with Commission Rule 63.04(b), 47 C.F.R. § 63.04(b)). No other applications are being filed with the Commission with respect to this transaction.

(a)(10) Prompt completion of the proposed transactions is critical to ensuring that Applicants can obtain the benefits described in the foregoing application. Accordingly, Applicants respectfully request that the Commission approve this Application expeditiously in order to allow Applicants to consummate the proposed transactions as soon as possible.

(a)(11) Not applicable.

(a)(12) A statement showing how grant of the application will serve the public interest, convenience and necessity is provided in **Section IV** above.

VII. CONCLUSION

For the reasons stated above, Applicants respectfully submit that the public interest, convenience, and necessity would be furthered by a grant of this Application. Indeed, failure to grant it would directly harm the public interest. In light of the exigent circumstances and, in particular the need to ensure continuity of service to existing customers, Applicants respectfully request expedited treatment to permit Applicants to consummate the proposed Transactions as soon as possible.

Respectfully submitted,

By: ______________________

William B. Wilhelm, Jr.
Brian McDermott
Swidler Berlin LLP
3000 K Street, NW, Suite 300
Washington, DC 20007-5116
(202) 424-7500 (Tel)
(202) 424-7645 (Fax)

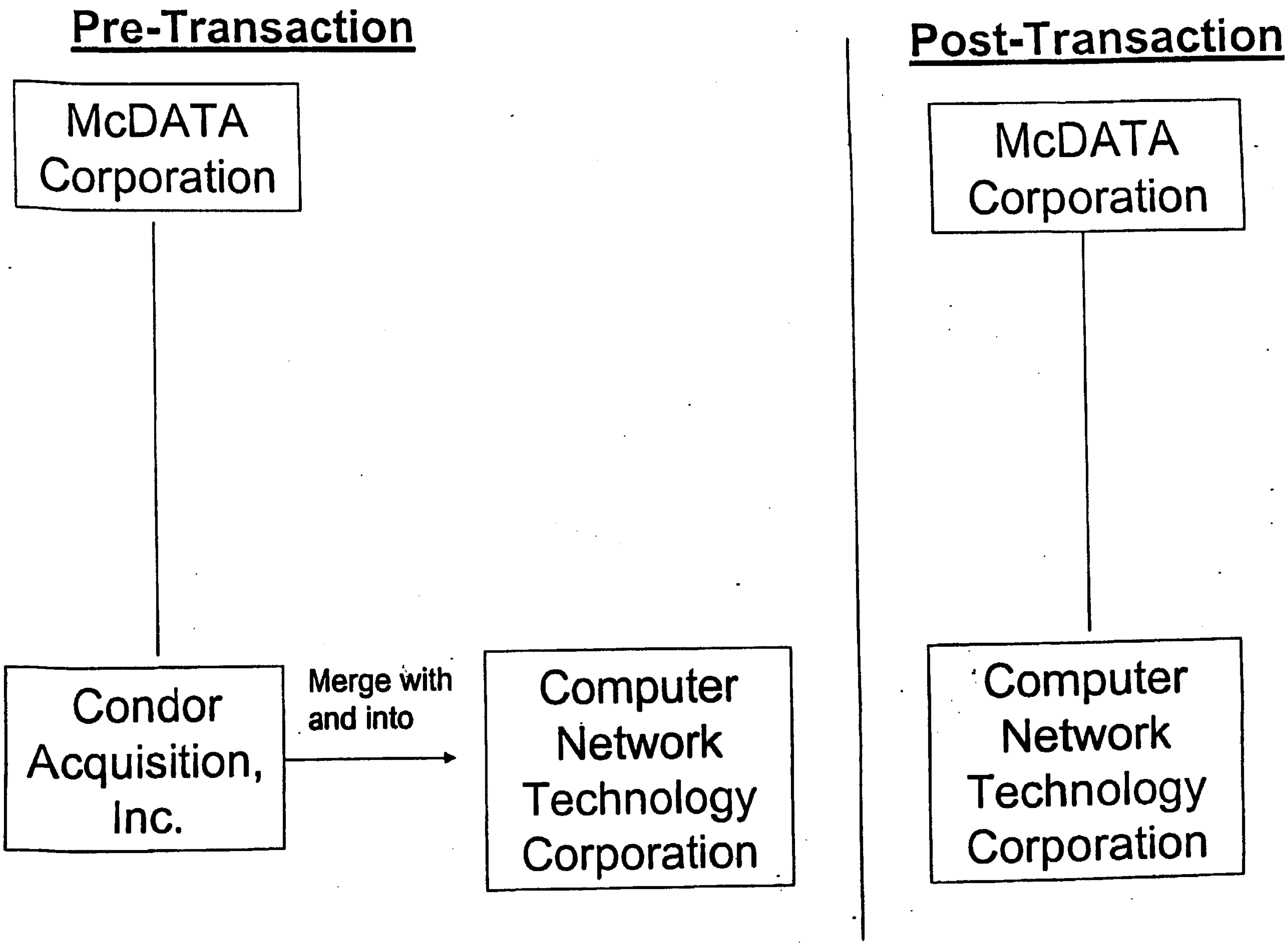
January 28, 2005

COUNSEL FOR APPLICATION

LIST OF EXHIBITS

Exhibit A

Illustrative Chart


Pre-Transaction
McDATA Corporation
Condor Acquisition, Inc.
Merge with and into
Computer Network Technology Corporation
Post-Transaction
McDATA Corporation
Computer Network Technology Corporation

<u>Exhibit B</u>

Financial Information

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended October 31, 2004

OR

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from ______ to ______

Commission File Number 000-31257

McDATA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**84-1421844**
(State or other jurisdiction of incorporation of organization)	**(I.R.S. Employer Identification No.)**

380 Interlocken Crescent, Broomfield, Colorado 80021
(Address of principal executive offices)(zip code)

(720) 558-8000
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(*d*) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **Yes** ☒ **No** ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). **Yes** ☒ **No** ☐

At November 30, 2004, 81,000,000 shares of the registrant's Class A Common Stock were outstanding and 38,042,765 shares of the registrant's Class B Common Stock were outstanding.

McDATA CORPORATION

FORM 10-Q
QUARTER ENDED OCTOBER 31, 2004
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Please Date Stamp And Return

SWIDLER BERLIN LLP

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VIA COURIER

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P.O. Box 358145
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FCC/MELLON JAN 28 2005

Re: Application of Computer Network Technology Corporation and McDATA Corporationn For Section 214 Authority to Transfer Control of an Authorized International Carrier

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Please direct any questions regarding this filing to the undersigned.

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Brian McDermott

Counsel for Applicants

Enclosure

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of the Joint Application of **Computer Network Technology Corporation** and **McDATA Corporation** Request For Grant of Authority Pursuant to Section 214 of the Communications Act of 1934, as amended, and Sections 63.04 and 63.24 of the Commission's Rules to Complete a Transfer of Control of Computer Network Technology Corporation, an Authorized International and Domestic Interstate Carrier	File No. ITC-T/C-2005 ______ WC Docket No. 05-__________

JOINT APPLICATION

I. INTRODUCTION

A. Summary of Transaction

Computer Network Technology Corporation ("CNT") and McDATA Corporation ("McDATA") (collectively, "Applicants"), pursuant to Section 214 of the Communications Act, as amended, 47 U.S.C.A. § 214, and Sections 63.04 and 63.24 of the Commission's rules, 47 C.F.R. §§ 63.04 & 63.24, notify the Commission and respectfully request authority to complete a series of transactions which will result in a transfer of control of Computer Network Technology Corporation.

B. Application Eligible for Streamlined Processing

Applicants respectfully submit that this Application is eligible for streamlined processing pursuant to Sections 63.03 and 63.12 of the Commission's Rules, 47 C.F.R. §§ 63.03 & 63.12. With respect to domestic authority, this Application is eligible for streamlined processing pursuant to Section 63.03(b)(2)(i) because, immediately following the transactions, (1) Applicants and their affiliates (as defined in Section 3(1) of the Communications Act – "Affiliates") combined will hold less than a ten percent (10%) share of the interstate, interexchange market; (2) Applicants and their Affiliates will provide local exchange service only in areas served by dominant local exchange carriers (none of which are parties to the proposed transactions) and; (3) none of the Applicants or their Affiliates are dominant with respect to any service. With respect to international authority, this Application is eligible for streamlined processing pursuant to Section 63.12(a)-(b) of the Commission's Rules, 47 C.F.R. §63.12(a)-(b). In particular, Section 63.12(c)(1) is inapplicable because none of the Applicants are foreign carriers, or are affiliated with any foreign carriers and none of the scenarios outlined in Section 63.12(c) of the Commission's Rules, 47 C.F.R. § 63.12(c), apply.

In support of this Application, Applicants provide the following information:

II. THE APPLICANTS

A. Computer Network Technology Corporation ("CNT")

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20030807-0413, effective October 6, 2003. *See* Public Notice Report No. TEL-00720; DA 03-3128, released October 9, 2003. After the consummation of the transaction, CNT will retain its authorization and will continue to provide services to its customers. Additional information on CNT is available on the company's website at: http://www.cnt.com and is incorporated herein by reference.

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Transaction will minimize the disruption of service and be virtually transparent to CNT' s customers.

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Bloomfield, Colorado 80021
(720) 558-8000 (Tel)

Licensee:
Computer Network Technology Corporation ("CNT")
6000 Nathan Lane North
Minneapolis, MN 55442
(763) 268-6000 (Tel)

Licensee is a publicly traded company so no individual Transferor exists.

---

[1] A copy of the Merger Agreement will be provided upon request.

63.18 (b) Jurisdiction of Organizations:

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McDATA is a corporation organized and existing under the laws of the State of Delaware.

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WBWilhelm@swidlaw.com (E-Mail)
BMMcDermott@swidlaw.com (E-Mail)

63.18 (d) Neither McDATA nor any of its subsidiaries have any licenses relating to the provision of telecommunications services.

CNT is authorized to provide facilities-based and resold international services pursuant to Section 214 authority granted in FCC File No. ITC-214-20030807-0413. CNT also holds blanket domestic Section 214 authority.

63.18 (h) McDATA is publicly traded on the Nasdaq National Market System. McDATA's Class A common shares are traded under the symbol "MCDTA" and its Class B common shares are traded under the symbol "MCDT".

Following the transactions, to the best of McDATA's knowledge no person or entities will directly or indirectly own ten percent (10%) or more of the equity of McDATA. As a result, McData following the proposed Transaction will be the only entity that directly or indirectly owns or controls more than 10% of CNT.

To the best of McDATA's knowledge, there are no officers or directors of McDATA that also serve as an officer or director of a foreign carrier as defined in Section 63.09(d).

63.18 (i) McDATA certifies that it is not a foreign carrier, nor is it affiliated with a foreign carrier, nor will McDATA be affiliated with a foreign carrier as a result of this transaction.

63.18 (j) McDATA certifies that it does not seek to provide international telecommunications services to any destination country where:

(1) McDATA is a foreign carrier in that country; or
(2) McDATA controls a foreign carrier in that country; or
(3) Any entity that owns more than 25 percent of McDATA, controls a foreign carrier in that country; or
(4) Two or more foreign carriers (or parties that control foreign carriers) own, in the aggregate more than 25 percent of McDATA and are parties to, or the beneficiaries of, a contractual relation affecting the provision or marketing or international basic telecommunications services in the United States.

63.18 (k) Not applicable.

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63.18 (n) McDATA certifies that it has not agreed to accept special concessions directly or indirectly from any foreign carrier with respect to any U.S. international route where the foreign carrier possesses market power on the foreign end of the route and will not enter into such agreements in the future.

63.18 (o) Applicants certify that they are not subject to denial of federal benefits pursuant to Section 5301 of the Anti-Drug Abuse Act of 1998. *See* 21 U.S.C. § 853a. *See also* 47 C.F.R. §§ 1.2001-1.2003.

63.18 (p) Applicants respectfully submit that this Application is eligible for streamlined processing pursuant to Section 63.12(a)-(b) of the Commission's Rules, 47 C.F.R. §63.12(a)-(b). In particular, Section 63.12(c)(1) is inapplicable because none of the Applicants are or are affiliated with any foreign carriers and none of the scenarios outlined in Section 63.12(c) of the Commission's Rules, 47 C.F.R. § 63.12(c), apply.

VI. INFORMATION REQUIRED BY SECTION 63.04

In lieu of an attachment, pursuant to Commission rule 63.04(b), 47 C.F.R. § 63.04(b) Applicants submit the following information in support of their request for domestic Section 214 authority in order to address the requirements set forth in Commission Rule 63.04(a)(6)-(12):

(a)(6) A description of the proposed Transactions is set forth in **Section III** above.

(a)(7) CNT provides interstate domestic telecommunications services throughout the United States. CNT also offers intrastate telecommunications services in Alabama, Arizona, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming and the District of Columbia. CNT has pending request for intrastate authorization in Alaska, Arkansas, California, Georgia, Maine, Pennsylvania and Virginia.

McDATA does not provide telecommunications services in any area.

Neither McDATA nor CNT is affiliated, as that term is defined in Section 3(1) of the Communications Act of 1934, as amended, with any other U.S. domestic common carrier not listed above.

(a)(8) Applicants respectfully submit that this Application is eligible for streamlined processing pursuant to Sections 63.03 of the Commission's Rules, 47 C.F.R. §63.03. In particular, with respect to domestic authority, this Application is eligible for streamlined processing pursuant to Section 63.03(b)(2)(i) because, immediately following the transactions, (1) Applicants and their affiliates (as defined in Section 3(1) of the Communications Act – "Affiliates") combined will hold less than a ten percent (10%) share of the interstate, interexchange market; (2) Applicants and their Affiliates will provide local exchange service only in areas served by dominant local exchange carriers (none of which are parties to the proposed transactions) and; (3) none of the Applicants or their Affiliates are dominant with respect to any service.

(a)(9) Through this Application, Applicants seek authority with respect to both international and domestic Section 214 authorizations (this Application is being separately and concurrently filed with respect to both types of authorities in compliance with Commission Rule 63.04(b), 47 C.F.R. § 63.04(b)). No other applications are being filed with the Commission with respect to this transaction.

(a)(10) Prompt completion of the proposed transactions is critical to ensuring that Applicants can obtain the benefits described in the foregoing application. Accordingly, Applicants respectfully request that the Commission approve this Application expeditiously in order to allow Applicants to consummate the proposed transactions as soon as possible.

(a)(11) Not applicable.

(a)(12) A statement showing how grant of the application will serve the public interest, convenience and necessity is provided in **Section IV** above.

VII. CONCLUSION

For the reasons stated above, Applicants respectfully submit that the public interest, convenience, and necessity would be furthered by a grant of this Application. Indeed, failure to grant it would directly harm the public interest. In light of the exigent circumstances and, in particular the need to ensure continuity of service to existing customers, Applicants respectfully request expedited treatment to permit Applicants to consummate the proposed Transactions as soon as possible.

Respectfully submitted,

By: ______________________

William B. Wilhelm, Jr.
Brian McDermott
Swidler Berlin LLP
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January 28, 2005

COUNSEL FOR APPLICATION

LIST OF EXHIBITS

Exhibit A

Illustrative Chart

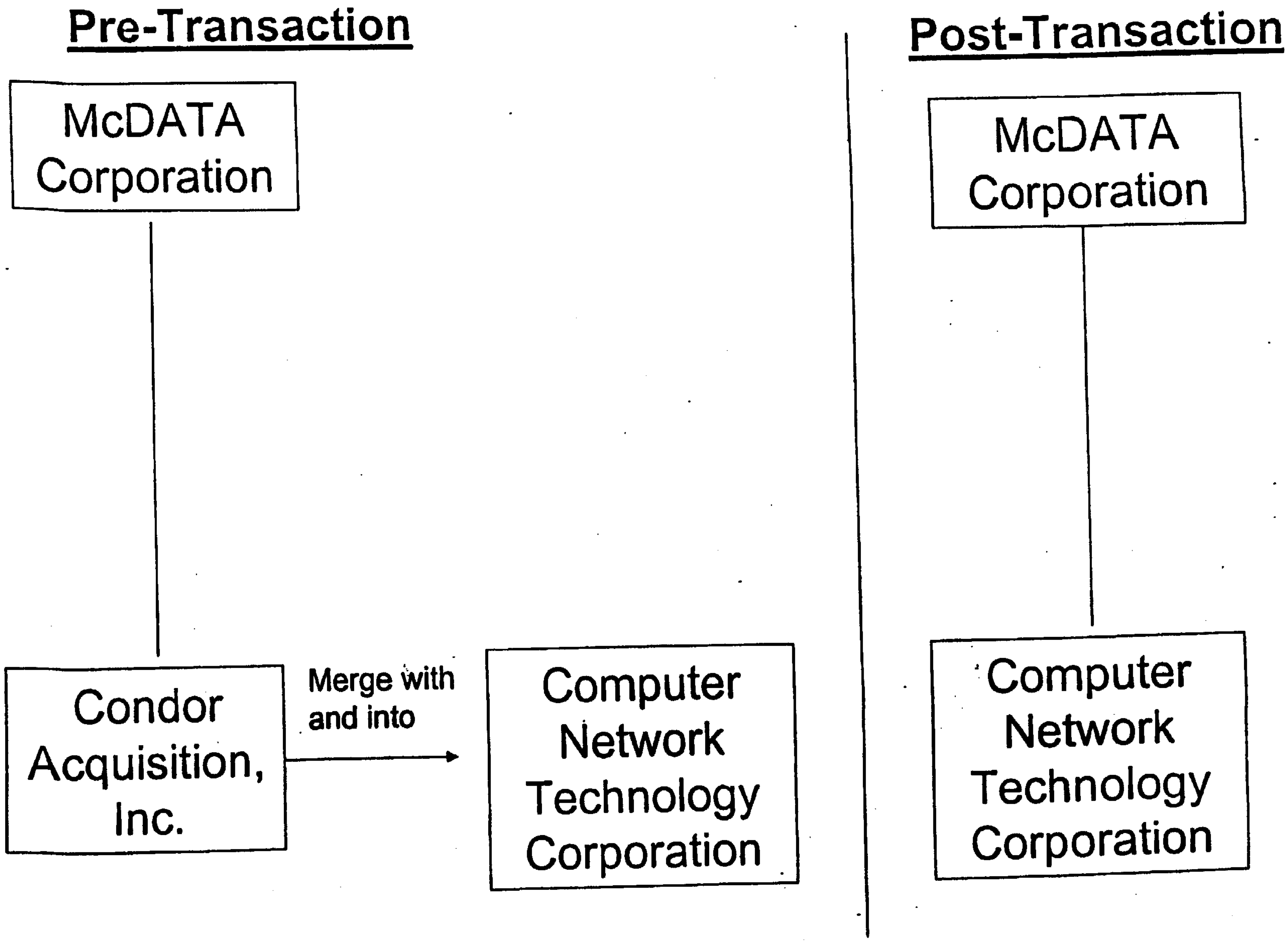
Pre-Transaction
McDATA Corporation
Condor Acquisition, Inc.
Merge with and into
Computer Network Technology Corporation
Post-Transaction
McDATA Corporation
Computer Network Technology Corporation

Exhibit B

Financial Information

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended October 31, 2004

OR

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______ to ______

Commission File Number 000-31257

McDATA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	84-1421844
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

380 Interlocken Crescent, Broomfield, Colorado 80021
(Address of principal executive offices)(zip code)

(720) 558-8000
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

At November 30, 2004, 81,000,000 shares of the registrant's Class A Common Stock were outstanding and 38,042,765 shares of the registrant's Class B Common Stock were outstanding.

McDATA CORPORATION

FORM 10-Q
QUARTER ENDED OCTOBER 31, 2004
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Item

Special Note Regarding Forward-Looking Statements

Some of the information presented in this Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Although McDATA Corporation ("McDATA" or the "Company," which may also be referred to as "we," "us" or "our") believes that its expectations are based on reasonable assumptions within the bounds of its knowledge of its businesses and operations; there can be no assurance that actual results will not differ materially from our expectations. Factors that could cause actual results to differ materially from expectations include:

- changes in our relationship with EMC Corporation, or EMC, International Business Machines Corporation, or IBM, Hitachi Data Systems, or HDS, and our other distribution partners and the level of their orders;
- our ability to successfully increase sales of McDATA's network switches and management software, including SANavigator®;
- competition in the multi-protocol (Fibre Channel and IP) network market, including competitive pricing pressures and product give-aways, by our competitors such as Brocade Communication Systems, Inc., or Brocade, QLogic Corp., or QLogic, Computer Network Technology Corporation, or CNT, Cisco Systems, Inc., or Cisco, and other IP and multi-protocol switch and software suppliers;
- our ability to expand our product offerings including our ability to successfully qualify and ramp sales of new products (including higher port density, multi-protocol and intelligent network products);
- unexpected engineering costs or delays, additional manufacturing and component costs or production delays that we may experience in connection with new product development;
- a loss of any of our key customers (and our OEMs' key customers), distributors, resellers, suppliers or our manufacturers;
- any change in business conditions, our business and sales strategy or product development plans, and our ability to attract and retain highly skilled individuals;
- any industry or technology changes that cause obsolescence of our products or components of those products;
- one-time events and other important risks and factors disclosed previously and from time to time in our filings with the U.S. Securities and Exchange Commission, or SEC, including the risk factors discussed in this Quarterly Report; and
- the impact of any acquisitions by us of businesses, products, or technologies, including difficulties in integrating any acquisitions.

You should not construe these cautionary statements as an exhaustive list or as any admission by us regarding the adequacy of the disclosures made by us. We cannot always predict or determine after the fact what factors would cause actual results to differ materially from those indicated by our forward-looking statements or other statements. In addition, you are urged to consider statements that include the terms "believes," "belief," "expects," "plans," "objectives," "anticipates," "intends," or the like to be uncertain and forward-looking. All cautionary statements should be read as being applicable to all forward-looking statements wherever they appear. We do not undertake any obligation to publicly update or revise any forward-looking statements.

PART I – FINANCIAL INFORMATION

McDATA CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	October 31, 2004 (unaudited)	January 31, 2004
[redacted]		
Current assets:		
[redacted]		
Securities lending collateral	141,361	126,681
[redacted]		
Accounts receivable, net of allowance for bad debts of $811 and $926, respectively	64,406	62,670
[redacted]		
Prepaid expenses and other current assets	6,764	6,055
[redacted]		
Property and equipment, net	98,096	99,225
[redacted]		
Restricted cash	5,029	5,130
[redacted]		
Goodwill	78,693	78,787
[redacted]		
Other assets, net	27,497	18,219
[redacted]		
[redacted]		
Current liabilities:		
[redacted]		
Accrued liabilities	40,759	53,330
[redacted]		
Current portion of deferred revenue	20,791	19,775
[redacted]		
[redacted]		
Obligations under notes payable and capital leases, less current portion	388	1,091
[redacted]		
Other long-term liabilities	2,020	—
[redacted]		
Convertible subordinated debt	172,781	172,151
[redacted]		
[redacted]		
Stockholders' Equity:		
[redacted]		
Common stock, Class A, $0.01 par value, 250,000,000 shares authorized, 81,000,000 shares issued and outstanding	810	810
[redacted]		
Additional paid-in-capital	481,799	476,993
[redacted]		
Deferred compensation	(3,620)	(10,375)
[redacted]		
Accumulated deficit	(62,590)	(41,798)

Total stockholders' equity	397,582	[illegible]
Total liabilities and stockholders' equity	$ 1,330,041	$ [illegible]

The accompanying notes are an integral part of these condensed consolidated financial statements.

McDATA CORPORATION
CONDENSED CONSOLIDATED INCOME STATEMENTS
(in thousands, except per share data)
(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2004	2003	2004	2003
[redacted]				
Cost of revenue	43,704	40,012	129,568	128,307
[redacted]				
Operating expenses (recoveries):				
[redacted]				
Selling and marketing (excludes amortization of deferred compensation included in Amortization of deferred compensation of $98, $643, $548 and $1,033, respectively)	26,755	23,531	74,477	70,452
[redacted]				
Acquired in-process research and development and other acquisition related costs	—	11,410	—	11,410
[redacted]				
Amortization of deferred compensation (excludes amortization of deferred compensation included in cost of revenue of $26, $285, $162 and $555, respectively)	1,050	5,719	4,797	8,620
[redacted]				
[redacted]				
Income (loss) from operations	(7,123)	(20,244)	(22,812)	187
[redacted]				
Interest expense	(395)	(221)	(862)	(2,497)
[redacted]				
Income tax expense (benefit)	(618)	30,852	40	38,210
[redacted]				
Equity in net loss of affiliated company	(262)	(591)	(1,380)	(591)
[redacted]				
[redacted]				
[redacted]				
[redacted]				
[redacted]				

The accompanying notes are an integral part of these condensed consolidated financial statements.

McDATA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended, October 31, 2004	Nine Months Ended, October 31, 2003
Cash flows from operating activities:		
Net loss	$ (20,792)	$ (35,603)
Adjustments to reconcile net loss to cash flows from operating activities:		
Depreciation	21,127	19,538
Amortization	[illegible]	[illegible]
Equity in net loss of affiliate	1,380	591
Loss on trade-in/retirement of assets	[illegible]	[illegible]
Net realized loss (gain) on investments	652	(191)
Inventory and inventory commitment provision	[illegible]	[illegible]
Acquired in-process research and development	—	11,410
Impairment loss	[illegible]	[illegible]
Bad debt provision	25	81
Deferred income taxes	[illegible]	[illegible]
Non-cash compensation expense	4,959	9,175
Tax benefit from stock options exercised	[illegible]	[illegible]
Unrealized gains on derivative transactions and cash equivalents	18	—
Changes in net assets and liabilities	[illegible]	[illegible]
Net cash provided by operating activities	[illegible]	[illegible]
Cash flows from investing activities:		
Purchases of property and equipment	[illegible]	[illegible]
Acquisitions	—	(171,174)
Equity investment	[illegible]	[illegible]
Purchases of investments	(349,582)	(591,554)
Proceeds from maturities and sales of investments	[illegible]	[illegible]
Net cash used by investing activities	[illegible]	[illegible]
Cash flows from financing activities:		
Net proceeds for issuance of convertible subordinated debt	[illegible]	[illegible]
Net purchase of share option transactions	—	(20,510)
Restricted cash related to interest rate swap	[illegible]	[illegible]
Purchase of treasury stock	(10,100)	—
Payments on long-term notes payable and capital lease	[illegible]	[illegible]
Proceeds from the issuance of common stock	5,500	5,624
Net cash provided (used) by financing activities	[illegible]	[illegible]
Net decrease in cash and cash equivalents	[illegible]	[illegible]
Cash and cash equivalents, beginning of period	50,301	108,168
Cash and cash equivalents, end of period	[illegible]	[illegible]
Supplemental Disclosure of Non-Cash Investing and Financing Activities:		
Deferred compensation forfeitures	$ 1,795	$ —
Capital lease obligations incurred	[illegible]	[illegible]
Fixed assets exchanged for capital leases	[illegible]	[illegible]
Transfer of inventory to fixed assets	[illegible]	[illegible]

The accompanying notes are an integral part of these condensed consolidated financial statements.

McDATA CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(tabular amounts in thousands, except per share data)
(unaudited)

Note 1 – Overview and Basis of Presentation

McDATA Corporation (McDATA or the Company) provides Multi-Capable Storage Network Solutions™ (integrating multiple platforms, networks, protocols and locations) that enables end-customers around the world to better utilize their storage infrastructure, easily manage the storage network and implement best-in-class business continuance solutions allowing them to be more efficient and effective. McDATA solutions are an integral part of data services infrastructures sold by most major storage and system vendors, including Dell Products L.P. (Dell), EMC Corporation (EMC), Hewlett-Packard (HP), Hitachi Data Systems (HDS), International Business Machines Corporation (IBM), StorageTechnology Corporation (STK) and Sun Microsystems, Inc. (Sun).

The accompanying condensed consolidated financial statements of McDATA and its subsidiaries have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the Company's annual consolidated financial statements have been condensed or omitted. The condensed consolidated balance sheet as of January 31, 2004 has been derived from the audited consolidated financial statements as of that date, but does not include all disclosures required by generally accepted accounting principles. For further information, please refer to and read these interim condensed consolidated financial statements in conjunction with the Company's audited consolidated financial statements for the year ended January 31, 2004.

The interim condensed consolidated financial statements, in the opinion of management, reflect all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows of the Company for the periods presented. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the entire fiscal year or future periods.

Recent Accounting Pronouncements

In January 2004, the Financial Accounting Standards Board (FASB) issued Emerging Issues Task Force (EITF) Issue No. 03-1, The Meaning of Other-Than Temporary Impairment and Its Application to Certain Investments (EITF 03-1). EITF 03-1 provides guidance on the disclosure requirements for other-than-temporary impairments of debt and marketable equity investments that are accounted for under Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). The adoption of EITF 03-1 would require the Company to include certain quantitative and qualitative disclosures for debt and marketable equity securities classified as available-for-sale or held-to-maturity under SFAS 115 that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. This guidance was to be effective for financial periods beginning after June 15, 2004; however, its adoption has been delayed due to proposed additional guidance concerning the impairment of debt securities. The Company does not anticipate that the adoption of this issue would have a material impact on the Company's financial position or results of operations.

Note 2 – ESCON Agreement Amendment

In 1997, the Company entered into a services agreement with McDATA Holdings Corporation, a wholly-owned subsidiary of EMC, to provide manufacturing and distribution management services for proprietary mainframe protocol, or ESCON™, switching solutions manufactured for and sold to IBM. Under the terms of this agreement, McDATA agreed to manage the ESCON product manufacture, design, order and product shipment in exchange for a service fee calculated as a fixed percentage of EMC's ESCON revenues. In the second quarter ended July 31, 2004, the Company amended the service agreement to effectively assume the ESCON business operations. This comprises the acceptance of the rights, risks and costs of inventory ownership and distribution; accounts receivable billing and collections; and sales and marketing activities.

Effective July 1, 2004, the Company began to fully consolidate the operations of the ESCON product line. Under this new arrangement, McDATA recorded $6.6 million of ESCON product revenue related to sales made from July 1 through October 31, 2004. In addition, the Company recorded the ESCON product inventory on the balance sheet and has included outstanding purchase commitments in the overall contract manufacturer commitments at October 31, 2004 (Note 15).

In connection with the assumption of the ESCON business, the Company renegotiated the prior service agreement with EMC to include an increased service fee percentage through June 30, 2004. As a result, during the quarter ended July 31, 2004, McDATA recognized $1.6 million of previously deferred revenue related to past service fees which were in dispute. Additionally, the Company remitted to EMC approximately $11 million of ESCON-related collections, which had been retained by the Company during the negotiations and classified in accrued liabilities in prior periods.

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Note 3 – Restructuring Charges

During the quarter ended January 31, 2004, the Company announced that it was taking certain cost improvement actions, which included a workforce reduction and facility consolidation. Total restructuring costs of $3.5 million consist of severance and benefit charges, facility closure expenses, and other charges. Severance and benefit charges of $2.3 million include severance and related employee termination costs associated with the reduction of the Company's workforce by approximately 92 employees, or 9%. Facility closure charges of $1.1 million relate to losses for a leased engineering facility in Toronto, Canada. In August 2004, the Company entered into agreements to sublease this facility to an unrelated third-party through the Company's remaining original lease term. In connection with these agreements, the Company made a one-time payment of approximately $1 million to satisfy all of its outstanding lease commitments for this facility. These payments were applied against the restructuring reserve accrual and approximate the original estimates made by the Company. As of October 31, 2004, all planned activities under this plan had been completed and all remaining accrued liabilities were paid or settled.

The following table summarizes the Company's utilization of restructuring accruals for the nine months ended October 31, 2004:

	Employee Severance Benefits	Facility Closure	Other Costs	Totals
Remaining accrual at beginning of period	$ 2,238	[illegible]	[illegible]	[illegible]
Expense provision	—	1,117	—	1,117
Cash payments and other	(2,297)	[illegible]	(219)	[illegible]
Changes in estimates	59	(132)	219	146
Accrual at end of period	$ —	[illegible]	[illegible]	[illegible]

Note 4 – Components of Selected Balance Sheet Accounts

	October 31, 2004	January 31, 2004
Inventories:		
Raw materials	$ 10,620	$ 7,037
Work-in-progress	[illegible]	[illegible]
Finished goods	11,001	7,883
Total inventories at cost	[illegible]	[illegible]
Less reserves	(5,671)	(4,476)
Total inventories, net	[illegible]	[illegible]

The Company has made significant investments in pre-production inventory related to new product introductions where technological feasibility has been established and are expected to be released in the fourth quarter of fiscal 2004 and the first half of fiscal 2005. The pre-production inventory includes both raw material component inventory to be utilized in final production as well as finished test product currently in the qualification and testing phases at OEM partner and end-user sites. Upon general availability, a portion of the test product will be sold and recognized as product revenue under revenue recognition guidelines.

	October 31, 2004	January 31, 2004
Accrued liabilities:		
Wages and employee benefits	$ 17,070	$ 17,489
Purchase commitments and other supply obligations	[illegible]	[illegible]
Warranty reserves (1)	4,299	4,522
Income taxes payable	[illegible]	[illegible]
Taxes, other than income tax	2,282	2,534
Interest payable	[illegible]	[illegible]
Customer obligations	6,258	4,729
ESCON agency funds	[illegible]	[illegible]
Restructuring reserve	—	2,238
Other accrued liabilities	[illegible]	[illegible]

(1) Activity in the warranty reserves is as follows:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2004	2003	2004	2003
[redacted]				
Warranty expense, net	68	181	563	844
[redacted]				
Warranty claims	(234)	(111)	(854)	(362)
[redacted]				

From time to time the Company is indemnified by its suppliers for warranty claims related to components that are contained within its products. In these circumstances, the Company records a non-expensed warranty obligation against which future warranty claims for those components will be provided by the Company to its customers.

Note 5 – Equity Investment

On August 22, 2003, the Company purchased 13.6 million shares of preferred stock, or approximately 17.3% of the total outstanding shares, of Aarohi Communications (Aarohi) for $6 million cash. Aarohi is a privately-owned provider of next-generation intelligent storage networking technology. In addition to the equity investment, the Company has entered into a non-exclusive supply arrangement with Aarohi to purchase their Application Specific Integrated Circuit chip for inclusion in the Company's new product launches when, and if, Aarohi's product becomes generally available. The Company has recorded its share of Aarohi's net loss of approximately $262,000 and $1.4 million for the three months and nine months ended October 31, 2004, respectively. Because the remaining net equity investment has been reduced to zero as of October 31, 2004, the Company will no longer recognize its share of Aarohi's net losses and will not provide for additional losses unless the Company commits to additional financial support for Aarohi, which the Company is not required to provide. If Aarohi subsequently reports net income, then McDATA will resume recognizing its share of Aarohi's net income only after its share of net income equals the share of net losses not recognized.

During the nine months ended October 31, 2004, the Company purchased software development services from Aarohi at a cost of $68,000. These expenses have been classified as research and development expenditures.

Summarized unaudited financial information for Aarohi is as follows:

Nine Months Ended September 30, 2004	
[redacted]	
Gross profit	$ 122
[redacted]	
Net loss	$ (9,084)

As of September 30, 2004	
[redacted]	
Noncurrent assets	$ 1,379
[redacted]	
Noncurrent liabilities	$ 2,197
[redacted]	
Retained deficit	$(30,712)

Note 6 – Goodwill and Intangible assets

Changes in the carrying amounts of goodwill are as follows:

[redacted]	
Purchase price adjustment	(94)
[redacted]	

The Company completed its acquisitions of Nishan Systems, Inc. and Sanera Systems, Inc. in the third quarter of 2003. No further material purchase adjustments are anticipated except for potential goodwill adjustments as a result of the potential future release of valuation allowance on the deferred tax assets of the acquired companies that was recorded at the time of the acquisitions.

The Company is currently amortizing its acquired intangible assets with finite lives over periods ranging from 1 to 6 years. During the quarter ended July 31, 2004, the Company identified the impairment of a customer relationship asset (the termination of Sanera's prior Original Equipment Manufacturer's Agreement with Computer Network Technology Corporation) with a net carrying value of $1.0 million. This impairment was mostly offset by the indemnification by former owners of Sanera. A net impairment charge of $50,000 was recorded in general and administrative expenses during the second quarter fiscal 2004. In connection with the cost improvement actions discussed in Note 3, the Company has retired a $2.2 million intangible asset related to the initial purchase of the Toronto operations in 1997. The asset was fully amortized and did not result in a loss. The following table summarizes the components of gross and net intangible asset balances:

	October 31, 2004			January 31, 2004		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$116,869	$26,482	$90,387	[illegible]	[illegible]	[illegible]
Customer relationships	1,622	604	1,018	3,021	340	2,681
Other	3,813	2,072	1,741	[illegible]	[illegible]	[illegible]
Total intangible assets	$122,304	$29,158	$93,146	[illegible]	[illegible]	[illegible]

Expected annual amortization expense related to acquired intangible assets is as follows:

Fiscal Years	
2004(1)	$ 5,553
2005	[illegible]
2006	19,494
2007	[illegible]
2008	17,418
Thereafter	[illegible]
Total expected amortization expense	[illegible]

---

(1) Reflects the remaining three months of fiscal 2004.

Amortization expense related to acquired intangible assets was $5.6 million and $2.5 million for the quarters ended October 31, 2004 and 2003, respectively. For the nine months ended October 31, 2004 and 2003, amortization of acquired intangible assets was $17.2 million and $3.6 million, respectively.

Note 7 – Interest and Other Income, Net

Interest and other income consists of:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2004	2003	2004	2003
Interest income	$1,786	[illegible]	[illegible]	[illegible]
Net realized gains/(losses) on available-for-sale investments	(170)	89	(653)	210
Unrealized gain (loss) on hedged investments	23	[illegible]	[illegible]	[illegible]
Interest and other income, net	$1,639	[illegible]	[illegible]	[illegible]

Note 8 – Income Tax

For the three months ended October 31, 2004 and October 31, 2003 the Company recorded an income tax benefit of $618,000
and a provision of $30.9 million, respectively. Income tax provisions of $40,000 and $38.2 million were recorded for the nine montl
ended October 31, 2004 and 2003, respectively. The tax provision for fiscal 2004 reflects foreign tax that McDATA will owe on the
profit of its foreign branch and subsidiary activities as well as state taxes where there are insufficient tax operating losses to offset
allocable taxable income. No federal tax benefit is recorded because the Company has established a valuation allowance against its
entire net domestic deferred tax asset. The tax benefit for the three months ended October 31, 2004 and the tax provision for the nin

MCDATA CORPORATION

months ended October 31, 2004 include a benefit from the reconciliation of US, state and Canadian tax return liabilities to taxes previously accrued. The tax provision for the three and nine months ended October 31, 2003 includes a non-cash charge of $38.7 million related to recording a valuation allowance against deferred tax assets.

Note 9 – Net Loss Per Share

Basic net loss per share excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted net loss per share is based on the weighted-average weighted-average number of common shares outstanding during each period and the assumed exercise of dilutive common stock equivalents less the number of number of shares outstanding during each period and the assumed exercise of dilutive common stock equivalents less the number of treasury shares assumed to be purchased from the proceeds using the average market price of the Company's common stock for each of the periods presented. A dilutive effect is included for shares sold in relation to McDATA's agreement with International Business Machines Corporation (IBM) in which the Company granted IBM five-year warrants for the purchase of up to 350,000 shares of McDATA's Class B common stock. The IBM warrants are fully discussed in Note 11. No dilutive effect has been included for the convertible subordinated debt issued February 7, 2003 or the share options sold in relation to the convertible subordinated debt because of their anti-dilutive impact.

Following is a reconciliation between basic and diluted loss per share:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2004	2003	2004	2003
Net loss	$ (6,523)	[illegible]	$ (120,793)	[illegible]
Weighted average shares of common stock outstanding used in computing basic net income (loss) per share	115,624	114,955	115,377	114,627
Effect of dilutive stock options and warrants	[illegible]	[illegible]	[illegible]	[illegible]
Weighted average shares of common stock used in computing diluted net loss per share	115,624	[illegible]	[illegible]	[illegible]
Basic net loss per share	$ (0.05)	[illegible]	[illegible]	[illegible]
Diluted net loss per share	$ (0.05)	[illegible]	[illegible]	[illegible]
Options and warrants not included in diluted share base because of the exercise price	11,401	[illegible]	[illegible]	[illegible]
Options, warrants and restricted stock not included in diluted share base because of the net loss	[illegible]	[illegible]	[illegible]	[illegible]

Note 10 – Stock-Based Compensation

The Company has stock-based employee compensation and employee stock purchase plans, which are described more fully in the Company's Annual Report on Form 10-K for the year ended January 31, 2004. In addition, the Board of Directors approved the Company's 2004 Inducement Equity Grant Plan (the 2004 Plan) in May 2004. The 2004 Plan provides for the issuance of non-qualified options, stock bonus awards, stock purchase awards, stock appreciation rights, stock unit awards and other stock awards for newly-hired employees of the Company. A maximum of 3 million shares are issuable under the 2004 Plan. As of October 31, 2004, there were approximately 6.3 million shares of common stock available for future grants under these plans.

The Company accounts for these plans according to Accounting Principles Board Opinion No. 25, Accounting for Stock Issues to Employees" (APB 25), and related interpretations and has adopted the disclosure-only alternative of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation" (SFAS No. 123), as amended by SFAS No. 148 Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123. Any deferred stock compensation calculated pursuant to APB 25 is amortized ratably over the vesting period of the individual options, generally two to four years. The following table illustrates the effect on net loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123.

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2004	2003	2004	2003
[redacted]				
Add: Total stock-based employee compensation expense included in net loss as determined under the intrinsic value method, net of related tax effects	1,076	6,004	4,959	9,175
[redacted]				
[redacted]				
[redacted]				
Basic-as reported	$ (0.05)	$ (0.44)	$ (0.18)	$ (0.31)
[redacted]				
[redacted]				
[redacted]				

Note 11– *Stockholders' Equity*

Stock Repurchase Plan

The Company's Board of Directors has authorized a plan for the Company to repurchase its common stock (Class A, Class B or a combination thereof). During the quarter ended October 31, 2004, the Board of Directors renewed the plan and reauthorized the repurchase of up to $50 million of its common shares. This repurchase plan expires on September 1, 2005 and allows the Company to repurchase shares on the open market, in negotiated transactions off the market, or pursuant to a 10b5-1 plan adopted by the Company. The Company adopted a 10b5-1 plan in September 2004, which allows the Company to repurchase its shares during a period in which the Company is in possession of material non-public information, provided the Company communicates share repurchase instructions to the broker at a time when the Company was not in possession of such material non-public information. During the quarter ended October 31, 2004, the Company purchased 2 million shares of Class B common stock for $10.1 million. Since inception of the plan, approximately 3.0 million shares (approximately 679,000 shares of Class A and approximately 2.3 million shares of Class B) have been repurchased with a total cost of $18.9 million.

Warrants to Purchase Stock

In September 2004, the Company entered into an OEM agreement with IBM. In connection with this agreement, the Company granted IBM five-year warrants for the purchase of up to 350,000 shares of McDATA's Class B common stock. The warrants are structured into three substantially equal tranches at exercise prices of $4.700, $5.052 and $5.405 per share. The warrants contain customary terms and conditions, including piggy-back SEC registration rights and anti-dilution protections in favor of IBM, and are fully exercisable. The warrants have been valued at approximately $1.0 million using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.29%, volatility of 80%, dividend rate of 0% and an expected life of five years. The warrants are recorded as an other asset related to the OEM contract and will be amortized ratably over the 60-month term of the OEM contract as a reduction to revenue.

Note 12 – Comprehensive Loss

Comprehensive loss consisted of the following:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2004	2003	2004	2003
[redacted]				
Unrealized loss on investments, net of tax	418	139	(746)	(304)
[redacted]				

Note 13 – *Segment Information*

The Company has one reporting segment relating to the design, development, manufacture and sale of open storage networking solutions that provide highly available, scalable and centrally managed storage area networks (SANs). The Company's Chief Operating Decision Makers, as defined by SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," allocate resources and assess the performance of the Company based on revenue and overall profitability.

A significant portion of revenue is concentrated with the largest storage OEMs. For the three months ended October 31, 2004, approximately 49% of total revenue came from EMC as compared to 54% for the three months ended October 31, 2003; IBM contributed approximately 23% of revenue compared to 21% for the three months ended October 31, 2003; and HDS contributed less than 10% for the three months ended October 31 2004, and approximately 10% for the three months ended October 31, 2003. For the nine months ended October 31, 2004, approximately 47% of total revenue came from EMC as compared to 59% for the nine months ended October 31, 2003; IBM contributed approximately 25% of total revenue compared to 19% for the nine months ended October 31, 2003; and HDS contributed approximately 10% of total revenue for the nine months ended October 31, 2004 and 2003. Other major storage and system vendors, including Dell, HP, STK and Sun, offer McDATA solutions to their customers. In addition to storage and system vendors, the Company has relationships with many resellers, distributors and systems integrators. Sales to these other channels represented 19% and 15% of total revenue, respectively for the three months ended October 31, 2004 and 2003 and 18% and 12% of total revenue, respectively for the nine months ended October 31, 2004 and 2003.

Revenues are attributed to geographic areas based on the location of the customers to which products are shipped. International revenues primarily consist of sales to customers in Western Europe and the greater Asia Pacific region. Included in domestic revenues are sales to certain OEM customers who take possession of products domestically and then distribute these products to their international customers. In addition, included in revenues from Western Europe are sales to certain OEM customers who take possession of products in distribution centers designated for international-bound product and then distribute these products among various international regions. The mix of international and domestic revenue can, therefore, vary depending on the relative mix of sales to certain OEM customers. Domestic and international revenue was approximately 66% and 34% of total revenue, respectively, for the three months ended October 31, 2004. For the three months ended October 31, 2003, domestic and international revenue was approximately 66% and 34% of total revenue, respectively. For the nine months ended October 31, 2004, domestic and international revenue was approximately 64% and 36% of total revenue as compared to 69% and 31%, respectively for the nine months ended October 31, 2003.

Note 14 – Related Party Transaction

In June 2004, the Company entered into a Software OEM Agreement (OEM Agreement) with Crosswalk, Inc. (Crosswalk). John F. McDonnell, a Class B shareholder of the Company and its former Chairman is the founder and sole director of Crosswalk. Pursuant to the OEM Agreement, the Company granted Crosswalk a license to develop and integrate the Company's SANavigator® software into Crosswalk's software platform, create certain enhancements for use with such integrated software product, and re-brand such integrated software product with Crosswalk's trademarks. The Company also granted Crosswalk a limited license to distribute the integrated software product furnished by the Company. The Company has deferred a $250,000 license fee and is recognizing license fee revenue over the license period of twelve months. Since entering into the agreement, the Company has recorded approximately $82,000 of revenue. Upon release and distribution of the Crosswalk proprietary software, software royalties will be recognized in accordance with the terms of the OEM Agreement and the Company's revenue recognition policies.

As of October 31, 2004, Mr. McDonnell is no longer a significant holder of the Company's common stock and, therefore, is no longer considered a related party.

Note 15 – Commitment and Contingencies

From time to time, the Company is subject to claims arising in the ordinary course of business. In the opinion of management and, except as set forth below, no such matter, individually or in the aggregate, exists which is expected to have a material adverse effect on the Company's consolidated results of operations, financial position or cash flows.

On September 9, 2004, the Company entered into a triple net office lease for the future lease of approximately 168,127 square feet of office space in Broomfield, Colorado (the "New Premises"). The Company intends to begin moving its current world headquarters location to the New Premises early in 2006 with lease payments commencing in February of 2006. The Company's current headquarter office lease expires at the end of April 2006. The term of the new lease is for 11 years (with two 5 year renewal options) and is at market lease rates that are substantially lower than the current lease rate paid by the Company. The base annual lease rates per rentable square foot for the New Premises range from $0 in the first year to $14.15 in the last year of the lease, plus normal operating expenses. In addition, the Company has an option to purchase the New Premises at varying amounts until December 31, 2005. The lease and option to purchase have customary terms and conditions.

Manufacturing and Purchase Commitments

The Company has contracted with Sanmina SCI Systems, Inc. (SSCI), Solectron Corporation (Solectron) and others (collectively, Contract Manufacturers) for the manufacture of printed circuit boards and box build assembly and configuration for specific multi-protocol directors and switches. The agreements require the Company to submit purchasing forecasts and place orders sixty calendar days in advance of delivery. At October 31, 2004, the Company's commitment with the Contract Manufacturers for purchases over the next sixty days totaled $62.7 million. The Company may be liable for materials that the Contract Manufacturers purchase on McDATA's behalf if the Company's actual requirements do not meet or exceed its forecasts and those materials cannot be redirected to other uses. At October 31, 2004, the Company had recorded obligations of approximately $6.6 million (See Note 4) primarily related to materials purchased by the Contract Manufacturers for certain end-of-life and obsolete material. Management does not expect the remaining commitments under these agreements to have a material adverse effect on the Company's business, results of operations, financial position or cash flows.

The Company has various other commitments for sales and purchases in the ordinary course of business. In the aggregate, such commitments do not differ significantly from current market prices or anticipated usage requirements.

Litigation

<u>Class Action Laddering Lawsuits</u>

The Company, John F. McDonnell, the former Chairman of the board of directors, Dee J. Perry, a former officer and Thomas O. McGimpsey a current officer were named as defendants in purported securities class-action lawsuits filed in the United States District Court, Southern District of New York. The first of these lawsuits, filed on July 20, 2001, is captioned Gutner v. McDATA Corporation, Credit Suisse First Boston (CSFB), Merrill Lynch, Pierce Fenner & Smith Incorporated, Bear, Stearns & Co., Inc., FleetBoston Robertson Stephens et al., No. 01 CIV. 6627. Three other similar suits were filed against the Company and the individuals. The complaints are substantially identical to numerous other complaints filed against other companies that went public in 1999 and 2000. These lawsuits generally allege, among other things, that the registration statements and prospectus filed with the SEC by such companies were materially false and misleading because they failed to disclose (a) that certain underwriters had allegedly solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriters allocated to those investors material portions of shares in connection with the initial public offerings, or IPOs, and (b) that certain of the underwriters had allegedly entered into agreements with customers whereby the underwriters agreed to allocate IPO shares in exchange for which the customers agreed to purchase additional company shares in the aftermarket at pre-determined prices. The complaints allege claims against the Company, the named individuals, and CSFB, the lead underwriter of the Company's August 9, 2000 initial public offering, under Sections 11 and 15 of the Securities Act of 1933. The complaints also allege claims solely against CSFB and the other underwriter defendants under Section 12(a)(2) of the Securities Act of 1933, and claims against the individual defendants under Section 10(b) of the Securities Exchange Act of 1934. Although management believes that all of the lawsuits are without legal merit and they intend to defend against them vigorously, there is no assurance that the Company will prevail.

In September 2002, plaintiffs' counsel in the above-mentioned lawsuits offered to individual defendants of many of the public companies being sued, including the Company, the opportunity to enter into a Reservation of Rights and Tolling Agreement that would dismiss without prejudice and without costs all claims against such persons if the company itself had entity coverage insurance. This agreement was signed by Mr. McDonnell, the former Company Chairman, Mrs. Perry, the former chief financial officer, and Mr. McGimpsey, the current Vice President of Business Development and General Counsel and the plaintiffs' executive committee. Under the Reservation of Rights and Tolling Agreement, the plaintiffs dismissed the claims against such individuals.

On February 19, 2003, the court in the above-mentioned lawsuits entered a ruling on the pending motions to dismiss, which dismissed some, but not all, of the plaintiffs' claims against the Company. These lawsuits have been consolidated as part of In Re Initial Public Offering Securities Litigation (SDNY). The Company has considered and agreed to enter into a proposed settlement offer with representatives of the plaintiffs in the consolidated proceeding, and we believe that any liability on behalf of the Company that may accrue under that settlement offer would be covered by our insurance policies. Until that settlement is fully effective, management intends to vigorously defend against the consolidated proceeding.

<u>Nishan Acquisition Related Lawsuit</u>

In connection with the Company's acquisition of Nishan, the Company was named along with Nishan, various investors of Nishan, CSFB and certain of the former board members and officers of Nishan in a lawsuit brought by Aamer Latif, a former board member and ex-CEO of Nishan, in the Superior Court of California, County of Santa Clara on September 11, 2003 (as amended on October 10, 2003 and March 24, 2004) entitled *Aamer Latif v. Nishan Systems, Inc. et al (103 CV 004 939)*. The Complaint makes various allegations against the other defendants such as fraud, directors' breach of the duty of care, shareholders' breach of fiduciary duty, unjust enrichment, and conspiracy to commit unjust enrichment. The allegations made against the Company are vote buying, unjust enrichment, and conspiracy to commit unjust enrichment. The allegation made against Nishan is breach of Section 1602 of the California Corporations Code (a provision dealing with books and records inspection). The complaint primarily seeks compensatory damages of approximately $11.5 million and other relief. The defendants have agreed that lawsuit expenses are covered by indemnification under the merger agreement from the selling shareholders of Nishan. The defendants filed a demurrer to dismiss this action, which was denied by the Court in January 2004. In May 2004, the defendants filed another demurrer to dismiss this action. On August 6, 2004, the defendants received a favorable ruling from the Judge. The Judge ruled against Mr. Latif and dismissed his claims since they were barred by California's appraisal rights statute (Corporations Code Section 1312(a)). The Judge also gave Mr. Latif 20 days leave to attempt to amend his complaint since it failed to state facts sufficient to constitute a legal cause of action. Mr. Latif subsequently amended his complaint and a demurrer hearing occurred on November 16, 2004. In late November, the Judge again ruled against Mr. Latif but gave Mr. Latif until December 10, 2004 to amend his complaint again. After significant review of the allegations made by the plaintiff, management strongly believes that the lawsuit is wholly without legal merit and the Company intends to vigorously defend against this action.

Indemnifications and Guarantees

During its normal course of business, the Company may enter into agreements with, among others, customers, resellers, OEMs, systems integrators and distributors. These agreements typically require the Company to indemnify the other party against product defects, third party claims or product infringements on patents or copyrights. The Company provides indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products.

In addition, the majority of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. The Company evaluates and estimates losses from such indemnification under SFAS No. 5, Accounting for Contingencies, as interpreted by FASB Interpretation No. 45. To date, the Company has not incurred any material costs as a result of such obligations and has not accrued any liabilities related to such indemnification and guarantees in our financial statements.

Note 16 – Subsequent Event

On November 22, 2004, the Company entered into a five year Master Joint Development and Marketing Agreement with QLogic Corporation, a Delaware corporation (QLogic). Pursuant to this agreement, the parties will jointly develop, market and distribute to select OEMs and other distribution channel partners certain joint embedded fabric switch and software offerings that consist of a QLogic embedded switch blade product for the server environment that is interoperable in McDATA fabrics and with McDATA's storage management and security software. QLogic will pay McDATA an initial fee of $4.0 million which will be deferred initially and recognized as revenue in accordance with SAB 104 at the expiration of the agreement. QLogic will also pay a unit royalty on sales of the joint product offering.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with the condensed consolidated financial statements and notes thereto included in Item 1 of this Quarterly Report and with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report filed on Form 10-K, with the Securities and Exchange Commission on April 15, 2004, and as amended on April 30, 2004 and August 23, 2004.

Overview

Competitive and Industry Environment

The market for our multi-protocol SAN switching hardware and software products is highly competitive. Our competitors are providing or plan to provide SAN switching and routing hardware and software that is multi-protocol capable such as Fibre Channel over IP (FCIP), SCSI over Internet (iSCSI), Internet Fibre Channel (iFCP) and InfiniBand (IB). A number of our current and potential competitors have longer operating histories, greater name recognition, access to larger customer bases, more established distribution channels and substantially greater financial and managerial resources. To remain competitive, we will need to build on the new products and technologies developed and acquired through our 2003 acquisitions of Nishan and Sanera as well as our investment in Aarohi Communications. In addition, we continue to expand our distribution channels for our product lines, including our Eclipse switch product line, which is based upon the technology acquired from Nishan. The financial results discussed below reflect our efforts to expand our channels and to develop our new hardware and software products for release in the last half of fiscal 2004 and first half of fiscal 2005. Our recent port sales of hardware products, reflect increases from the third quarter of fiscal 2003 and sequentially from the second quarter of fiscal 2004. Additionally, our Eclipse SAN routing switch saw a growth in year to date sales since its release in the fourth quarter of fiscal 2003. In addition, our software revenue has steadily increased from prior years to represent almost 15% of total revenue; up from 11% in the third quarter of 2003. Our operating expense results reflect our continued product development efforts and, in the last half of 2004, will reflect development and launch-related expenditures as we introduce new products.

We believe that we are well positioned in the industry with a full complement of hardware and software products that customers require for the next phase of their infrastructure development. Management believes the trend of revenue, control of operating expense and the related competitive environment define the overall performance of the Company and provide a specific context to further analyze the financial results of the company.

Revenue Reclassification

Beginning second quarter ended July 31, 2004, we have presented a reformatted classification of revenue to provide further visibility into our product lines and to emphasize our software growth strategy. All prior periods have been reclassified to reflect the new classification. Our revenue comprises the following product categories:

- Product Revenue – revenue from the sales of our director and switch products (including Eclipse SAN routers).
- Software and Related Maintenance Revenue – revenue from the sales of our software licenses and related maintenance agreements. Our software maintenance agreements consist of our standard post-contract services (PCS) that are sold in conjunction with the initial sales of the software licenses. These services include customer support that provides bug fixes, upgrades and telephone support.
- Other Service Revenue – revenue from our professional service offerings as well as services provided under extended maintenance and upgraded warranty contracts for our hardware products.
- ESCON Revenue – historical revenue earned from the ESCON service agreement and, beginning July 1, 2004, revenue from our ESCON product sales.

ESCON Agreement Amendment

In 1997, we entered into a services agreement with McDATA Holdings Corporation, a wholly-owned subsidiary of EMC, to provide manufacturing and distribution management services for proprietary mainframe protocol, or ESCON™, switching solutions manufactured for and sold to IBM. Under the terms of this agreement, we agreed to manage the ESCON product manufacture, design, order and product shipment in exchange for a service fee calculated as a fixed percentage of EMC's ESCON revenues. In the second quarter ended July 31, 2004, we amended the service agreement to effectively assume the ESCON business operations. This comprises the acceptance of the rights, risks and costs of inventory ownership and distribution; accounts receivable billing and collections; and sales and marketing activities. We elected to amend the service agreement and effectively assume the ESCON business operations for two primary reasons. First, we believe that the gross margin dollars that we will earn by managing the business in its entirety will exceed the service fees we would have earned under the prior arrangement. Second, as a result of our amendment of the service agreement, we obtained a retroactive increase in the prior service fee.

Therefore, effective July 1, 2004, we began to fully consolidate the operations of the ESCON product line. Under this new arrangement, we have recorded $6.6 million of ESCON product revenue related to sales made from July 1 through October 31, 2004. In addition, we recorded the ESCON product inventory on our balance sheet and have included outstanding purchase commitments in our overall contract manufacturer commitments at October 31, 2004. The ESCON technology is a mature technology, and therefore, we anticipate revenues from this product line will decline over time. In the Results of Operations discussion, we classify the ESCON revenue results as "ESCON revenue" in an effort to segregate this business from our current product sales, including our next-generation products, which will be introduced in the fourth quarter of fiscal 2004.

In addition to the assumption of the ESCON business, the Company renegotiated the prior service agreement with EMC to include an increased service fee percentage through June 30, 2004. As a result, in the second quarter ended July 31, 2004, we recognized $1.6 million of previously deferred revenue related to past service fees which were in dispute. Additionally, we remitted to EMC approximately $11 million of ESCON-related collections, which were retained by us during the negotiations and classified in accrued liabilities in prior periods.

Results of Operations

The following table sets forth certain financial data for the periods indicated as a percentage of total revenues.

	Three Months Ended October 31, 2004	Three Months Ended October 31, 2003	Nine Months Ended October 31, 2004	Nine Months Ended October 31, 2003
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	44.4	42.3	44.1	42.1
Gross profit	55.6	[illegible]	55.9	[illegible]
Operating expenses:				
Research and development	[illegible]	[illegible]	[illegible]	[illegible]
Selling and marketing	27.2	24.8	25.3	23.1
General and administrative	5.8	[illegible]	6.6	[illegible]
Acquired in-process research and development	—	12.1	—	3.7
Amortization of purchased intangible assets	5.7	[illegible]	[illegible]	[illegible]
Amortization of deferred compensation	1.1	6.0	1.6	2.8
Restructuring charges	(0.1)	[illegible]	[illegible]	[illegible]
Total operating expenses	62.8	[illegible]	[illegible]	[illegible]
Income (loss) from operations	(7.2)	(21.4)	(7.7)	0.1
Interest and other income, net	1.3	[illegible]	[illegible]	[illegible]
Income (loss) before income taxes and equity in loss of affiliated company	(5.9)	[illegible]	[illegible]	[illegible]
Income tax expense (benefit)	(0.6)	32.6	—	12.5
Loss before equity in net loss of affiliated company	(5.3)	[illegible]	(6.5)	[illegible]
Equity in net loss of affiliated company	(0.3)	(0.6)	(0.5)	(0.2)
Net loss	(5.6)%	(52.9)%	(7.0)%	[illegible]

Revenues

	Three Months Ended October 31, 2004	Three Months Ended October 31, 2003	Nine Months Ended October 31, 2004	Nine Months Ended October 31, 2003
Product revenue	$73,210	[illegible]	[illegible]	[illegible]
Software and related maintenance revenue	14,563	10,832	42,428	29,702
Other service revenue	5,720	[illegible]	[illegible]	[illegible]
ESCON revenue	5,032	623	9,587	1,643
Total Revenue	$98,525	[illegible]	[illegible]	[illegible]

Product revenue of $73.2 million for the three months ended October 31, 2004 decreased 9% from $80.1 million for the three months ended October 31, 2003. This decline in product revenue reflects a 16% increase in estimated director and switch ports sold offset by a 24% decrease in estimated average sales prices. Product revenue of $227.4 million for the nine months ended October 31, 2004 decreased 14% from $265.3 million for the nine months ended October 31, 2003. This decline in product revenue reflects a 2% increase in estimated ports sold which partially offsets a 17% decrease in estimated average sales prices from the nine months ended October 31, 2003. The increase in sales of hardware ports reflects the market strength of our flex ports as well as our mid-range switch products despite the economic and competitive environment which has lengthened the decision making process of our end-users and lengthened our sales cycles. We expect the number of ports shipped to fluctuate depending on the demand for our existing and newly introduced products including the timing of product introductions by our OEM customers. Average sales price declines during the third quarter were greater than the historical pricing declines typical with our technology products. During the third quarte ended October 31, 2004, we lowered pricing on director chassis to take advantage of the ongoing competitive environment in the high-end director product category. These price declines were enabled by the lowered costs of our director components. We anticipat the gross margin impact from these pricing actions will be mitigated by the growth in higher margin software sales. Ongoing competition and macroeconomic factors could continue to provide downward pricing pressures that could impact our revenue growth and related margins. Product revenue for the third quarter ended October 31, 2004, includes approximately $1.3 million of product revenue recorded as a result of previously deferred revenue recognized upon our change in estimates for distributor sales. See further discussion under the Revenue Recognition section of the Critical Accounting Policies.

For the three months ended October 31, 2004, software revenue of $14.6 million was a 34% increase from $10.8 million for the three months ended October 31, 2003. Software revenue of $42.4 million for the nine months ended October 31, 2004 increased 43% from $29.7 million for the nine months ended October 31, 2003. This revenue growth is due to continued revenue growth from our software products, including our SANavigator®, SANtegrity® and SAN routing software.

Other service revenue includes professional service revenue and revenue earned from our upgraded warranty and extended maintenance contracts on our hardware products. For the three months ended October 31, 2004, other service revenue increased 83% to $5.7 million as compared to $3.1 million for the three months ended October 31, 2003. For the nine months ended October 31, 2004, other service revenue increased 78% to $14.6 million as compared to $8.2 million for the nine months ended October 31, 2003. These increases are due primarily to the activation of extended maintenance and upgraded warranty contracts sold in conjunction with our hardware products. In prior periods, we experienced a significant growth in deferred revenue as the attach rates for extended maintenance contracts increased significantly (primarily through IBM sales). As the standard product warranties on these products expire, we will continue to see a growth in maintenance revenue as the extended contracts are activated and deferred revenue is recognized. As part of our recently announced OEM agreement with IBM, we will no longer provide the end-user support services through these extended maintenance contracts. Therefore, revenue from deferred extended maintenance contracts is expected to decline in fiscal 2006.

ESCON revenues of $5.0 million for the three months ended October 31, 2004 increased $4.4 million from $0.6 million for the three months ended October 31, 2003. ESCON revenues of $9.6 million for the nine months ended October 31, 2004 increased $7.9 million from the $1.6 million for the same period in fiscal 2003. The increase reflects McDATA's assumption of the ESCON business operations from EMC during the second quarter of fiscal 2004 as explained above. As of July 1, 2004, ESCON revenue included product revenue from sales of these products. In addition, ESCON revenue for the nine months ended October 31, 2004 includes $1.6 million of previously deferred service fees discussed in the Overview above. These fees were deferred in prior periods in accordance with revenue recognition policies and the contract negotiations at that time.

A significant portion of our revenue is concentrated with the largest storage OEMs. For the three months ended October 31, 2004, approximately 49% of our total revenue came from EMC as compared to 54% for the three months ended October 31, 2003; IBM contributed approximately 23% of our revenue compared to 21% for the three months ended October 31, 2003; and HDS contributed less than 10% for the three months ended October 31 2004, and contributed 10% of total revenue for the three months ended October 31, 2003. For the nine months ended October 31, 2004, approximately 47% of our total revenue came from EMC as compared to 59% for the nine months ended October 31, 2003; IBM contributed approximately 25% of total revenue compared to 19% for the nine months ended October 31, 2003; and HDS contributed approximately 10% of total revenue for the nine months ended October 31, 2004 and 2003. Other major storage and system vendors, including Dell, HP, STK and Sun, offer McDATA solutions. In addition to our storage and system vendors, we have relationships with many resellers, distributors and systems integrators. Sales to these other channels represented 19% and 15%, respectively for the three months ended October 31, 2004 and 2003 and 18% and 12%, respectively for the nine months ended October 31, 2004 and 2003. The decline in the revenue from EMC as a percentage of our sales is the result of the entrance of new competitors into the storage market and the lengthened sales cycle in the high-end director market; as well as the overall growth in revenue dollars from our other OEMs and non-OEM channels, particularly IBM with whom we have a strengthened relationship. Expanding our reseller, distributor and system integrator channels into Small Medium Enterprise (SME) and vertical markets will be a strategic focus for us as we continue to grow our business. However, the level of sales to any single customer may vary and the loss of any one significant customer, or a decrease in the level of sales to any significant or group of significant customers, could harm our financial condition and results of operations. Given the dependencies on our limited number of OEM resellers combined with an increasingly competitive environment, we may experience continued adverse price pressures at critical times near the end of the fiscal quarters. In addition, the fiscal quarters for many of our largest OEM and reseller partners begin during the last month of our fiscal quarter. While we do not have complete insight into the purchasing processes of our OEM and reseller partners, we believe that such partners may purchase some amount of our non-configured product in anticipation of end-user customer demand that will be realized in the later portion of their fiscal quarter. Large end-of-quarter purchases by our partners could result in lower future revenues or earnings if market demand as forecasted by our partners is not met.

Domestic and international revenue was approximately 66% and 34% of our total revenue, respectively, for the three months ended October 31, 2004. For the three months ended October 31, 2003, domestic and international revenue was approximately 66% and 34% of our total revenue, respectively. For the nine months ended October 31, 2004, domestic and international revenue was 64% and 36% of total revenue as compared to 69% and 31%, respectively for the nine months ended October 31, 2003. Revenues are attributed to geographic areas based on the location of the customers to which our products are shipped. International revenues primarily consist of sales to customers in Western Europe and the greater Asia Pacific region. Included in domestic revenues are sales to certain OEM customers who take possession of our products domestically and then distribute these products to their international customers. In addition, included in revenues from Western Europe are sales to certain OEM customers who take possession of our products in distribution centers designated for international-bound product and then distribute these products among various international regions. Our mix of international and domestic revenue can, therefore, vary depending on the relative mix of sales to certain OEM customers.

Gross Profit

Gross profit margin of 56% for the three months ended October 31, 2004 reflects a 210 basis point decline from the gross profit margin of 58% for the three months ended October 31, 2003. Costs of goods sold consists of product costs, which are generally variable, and manufacturing operating cost, which include both variable and fixed expenses. Product costs as a percentage of revenue increased approximately 1.0% due to lower product revenue and revenue growth in lower margin service products, which were partially offset by higher margin software sales and lowered component costs. Manufacturing operating costs as a percentage of revenue increased 1.1% due to the release of inventory-related reserves during the third quarter of fiscal 2003 and higher product royalty charges during the third quarter of fiscal 2004.

For the nine months ended October 31, 2004 and 2003, gross profit margin was 56% and 58%, respectively, reflecting a decrease of 200 basis points. Product costs as a percentage of revenue increased 0.5% due to lower product revenues and growth in lower margin service products, which were partially offset by increases in higher margin software sales, lower component costs and the one-time increase in revenue due to retroactive ESCON service fees. Manufacturing operating costs as a percentage of revenue increased 1.5% due primarily to the release of inventory-related reserves and obligations of approximately $2.7 million or 0.9% of the nine-month 2003 gross margins reported above.

In anticipation of the competitive-driven and natural decline in selling prices, we continue to drive cost advantages through our engineering and manufacturing processes. In April 2004, we announced the availability of the lower cost versions of our second-generation switch technology and began shipping the lower cost versions of our director components. Through these actions, we anticipate gross profit margin will remain in the mid-50 percent range through the fourth quarter of fiscal 2004.

Operating Expenses

Research and Development Expenses. Research and development expenses consist primarily of salaries and related expenses for personnel engaged in engineering and R&D activities; fees paid to consultants and outside service providers; nonrecurring engineering charges; prototyping expenses related to the design, development, testing and enhancement of our products; depreciation related to engineering and other test equipment; and IT and facilities expenses.

For the three months ended October 31, 2004, research and development expenses decreased $0.8 million to $22.8 million compared with $23.6 million for the three months ended October 31, 2003. Research and development expenses reflect the net impact of capitalized software development costs which reduce research and development expenses when recorded on the balance sheet and amortized against cost of goods sold upon introduction of the software product. In the third quarter ended October 31, 2004, capitalized software costs were $6.0 million compared to $2.2 million for the three months ended October 31, 2003. These costs vary in conjunction with stages of development of our application software, our new director and switch products and related firmware software. The decrease caused by the capitalization of software development expenses was partially offset by a $1.0 million increase in personnel related expenses attributable to our third quarter 2003 acquisitions and a $1.5 million increase in spending related to product development and testing of our new products scheduled for general availability in the fourth quarter of fiscal 2004 and the first quarter of fiscal 2005.

For the nine months ended October 31, 2004, research and development increased by $9.4 million to $70.0 million as compared with $60.5 million for the nine months ended October 31, 2003. This increase was primarily due to a $8.2 million increase in personnel related expenses attributable to fiscal 2003 acquisitions and a $8.7 million increase in spending related to new product development and testing. This increased spending was partially offset by increases in the capitalization of software development costs during fiscal 2004. Capitalized software costs for the nine months ended October 31, 2004, increased to $12.9 million as compared to $4.8 million for the nine months ended October 31, 2003.

Selling and Marketing Expenses. Sales and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in marketing and sales; costs associated with promotional and travel expenses; and IT and facilities expenses.

For the three months ended October 31, 2004, selling and marketing expenses increased $3.2 million to $26.8 million as compared to $23.5 million for the three months ended October 31, 2003. This increase was primarily due to a $1.8 million increase for personnel expenses as well as increases in equipment costs, and tradeshow and marketing activities totaling $1.4 million

For the nine months ended October 31, 2004, selling and marketing expenses increased by $4.0 million to $74.5 million as compared to $70.5 million for the nine months ended October 31, 2003. Increases in personnel, travel and equipment costs of $4.8 million in fiscal 2004 were offset by a $1.0 million decrease in customer acquisition costs from the nine months ended October 31, 2003 attributable to two new OEM contracts signed during that period.

General and Administrative Expenses. General and administrative expenses consist primarily of salaries and related expenses for corporate executives, finance, human resources and investor relations, as well as accounting and professional fees, corporate legal expenses, other corporate expenses, and IT and facilities expenses.

For the three months ended October 31, 2004 and 2003, respective, general and administrative expenses were $5.8 million and $8.1 million. For the nine months ended October 31, 2004 and 2003, respectively, general and administrative expenses were $19.5 million and $21.8 million. These decreases over prior year are attributable to several litigation matters the Company was involved in during fiscal 2003 which were subsequently settled.

Amortization Of Purchased Intangible Assets. Amortization of purchased intangible assets was $5.6 million and $2.5 million for the three months ended October 31, 2004 and 2003, respectively; and $17.2 million and $3.6 million for the nine months ended October 31, 2003, respectively. The increases were the result of our fiscal 2003 acquisitions through which we recorded approximately $113 million of amortizable intangible assets. These assets are being amortized on a straight-line basis over a period of one to nine years.

Amortization of Deferred Compensation. Amortization of deferred compensation was $1.0 million for the three months ended October 31, 2004, and $5.7 million for the three months ended October 31, 2003 (of which approximately $26,000 and $285,000 was included in cost of revenue, respectively). Deferred amortization expense of $4.8 million was recorded for the nine months ended October 31, 2004 and $8.6 million for the same period October 31, 2003 (of which approximately $162,000 and $555,000 was included in cost of revenue, respectively). We have recorded deferred compensation in connection with Class B common stock options granted prior to our August 9, 2000 initial public offering (IPO) and restricted Class B stock grants granted through our equity incentive plans. In addition, we issued approximately 1.0 million shares of Class B restricted common stock with vesting periods ranging from 12 to 24 months in connection with our acquisitions during fiscal 2003. We are amortizing all deferred compensation on a straight-line basis over the vesting period of the applicable options and stock awards. Deferred compensation expense related to these awards will decrease as the awards become fully vested over the following two to five years.

Restructuring Charges. In the fourth quarter of fiscal 2003, we announced that we were taking certain cost improvement actions, which included a workforce reduction and facility consolidation. During the nine months ended October 31, 2004, we completed our planned closure of our Toronto engineering facility and recorded an approximate $1.1 million restructuring charge related to this closure. In addition, we incurred an additional $279,000 restructuring charge in fiscal 2004 for additional severance-related and other costs as we finalized the reduction in workforce that was initiated in the fourth quarter of 2003. As of October 31, 2004, all planned activities under this plan had been completed and all remaining accrued liabilities were paid or settled.

Interest and Other Income. Interest and other income consisted primarily of interest earnings on our cash, cash equivalents and various investment holdings. Interest and other income decreased to $1.6 million for the three months ended October 31, 2004 as compared with $1.9 million for the three months ended October 31, 2003. Interest and other income decreased to $4.3 million for the nine months ended October 31, 2004 as compared with $5.5 million for the nine months ended October 31, 2003. This decrease in income reflects the use of a portion of our investment portfolio to fund our third quarter 2003 acquisitions. Fluctuations in our investment balances as well as fluctuations in interest rates could cause our investment income to vary between periods.

Interest Expense. For the three months ended October 31, 2004, interest expense increased slightly to $0.4 million compared with $0.2 million for the three months ended October 31, 2003. For the nine months ended October 31, 2004, interest expense decreased $1.6 million to $0.9 million compared to $2.5 million for the nine months ended October 31, 2003. The decrease in interest expense from the nine months ended October 31, 2003 to 2004 was attributable to the interest rate swap which was established during the third quarter fiscal 2003. This interest-rate swap agreement has the economic effect of modifying the fixed interest obligations associated with our convertible debt so that the interest payable on the majority of the debt effectively becomes variable based on the six-month London Interbank Offered Rate (LIBOR) minus 152 basis points. The reset dates of the swap are February 15 and August 15 of each year until maturity on February 15, 2010. On August 16, 2004, the six-month LIBOR setting was reset to 1.92%, resulting in a rate of approximately 0.4%, which is effective until February 15, 2005. Significant increases in interest rates in future periods could significantly increase interest expense.

Provision for Income Taxes. The Company has recorded tax expense for the nine months ended October 31, 2004 even though the pre-tax result on the books is a loss. This is due primarily to taxes payable in foreign jurisdictions where the net taxable income will be positive. No tax benefit is realized currently for the book loss or available tax credits as the Company has established a valuation allowance against its entire domestic net deferred tax assets. The tax provision for the three and nine months ended October 31, 2003 includes a non-cash charge of $38.7 million related to recording a valuation allowance against deferred tax assets.

We are subject to audit by federal, state and foreign tax authorities. These audits may result in additional tax liabilities. We account for such contingent liabilities in accordance with SFAS No. 5, Accounting for Contingencies, and believe that we have appropriately provided for taxes for all years. Several factors drive the calculation of our tax reserves including (i) the expiration of statutes of limitations, (ii) changes in tax law and regulations, and (iii) settlements with tax authorities. The occurrence of any of these events may result in adjustments to our reserves that could impact our reported financial results.

The Internal Revenue Service is currently conducting an audit of the Company's US income tax returns for 2000, 2001 and 2002. An audit of these years is mandated by the procedures for Joint Committee cases due to the carry back of tax losses from the 2001 and 2002 tax years to 2000. In addition, the state of Colorado has completed a review of income tax returns filed by the Company with the state for 2001 and 2002. We received notification from the state auditor on November 4, 2004 that no changes would be proposed with respect to those returns.

Liquidity and Capital Resources

Our financial condition remains solid. At October 31, 2004, cash, short- and long-term investments were $303 million compared to approximately $317 million as of January 31, 2004. These balances include approximately $5 million of restricted cash that we are required to maintain in relation to the interest rate swap we have executed in connection with our convertible debt. We invest excess cash predominantly in debt and equity instruments that are highly liquid, of high-quality investment grade, and predominantly have maturities of less than three years with the intent to make such funds readily available for operating purposes, including expansion of operations and potential acquisitions or other transactions.

We believe our existing cash, short-term and long-term investment balances, and cash expected to be generated from future operations will be sufficient to meet our capital and operating requirements at least through the next twelve months, although we could be required, or could elect, to seek additional funding prior to that time. Our future capital requirements will depend on many factors, including our rate of revenue growth, the timing and extent of spending to support development of new products and expansion of sales and marketing, the timing of new product introductions and enhancements to existing products, and market acceptance of our products.

In summary, our cash flows were:

Source/(use) (in thousands)	Nine Months Ended October 31, 2004	Nine Months Ended October 31, 2003
Net cash provided by operating activities	$ 6,65[illegible]	$ [illegible]
Net cash used by investing activities	(5,750)	(243,947)
Net cash provided (used) by financing activities	(6,816)	[illegible]

The decrease in cash provided by operating activities reflects the net loss for the nine months ended October 31, 2004 adjusted for non-cash charges including depreciation, amortization, deferred compensation and changes in working capital items. Working capital items include accounts receivable, inventories, other current and non-current assets, accounts payable, accrued liabilities and deferred revenue. Accounts receivable was a use of $1.5 million in the first nine months of fiscal year 2004 compared to a use of $23.5 million in the first nine months of 2003. Days sales outstanding (DSO) was 60 days and 58 days for the nine months ended October 31, 2004 and 2003, respectively. The change between years is the result of the timing and collections compared to the linearity of billings within the quarter. The use of cash of $13.6 million during the first nine months of fiscal 2004 for the net purchase of inventories compares to the $5.5 million use of cash during the same period of fiscal 2003. The increased purchasing reflects the build of inventories surrounding the next generation of products that are currently in the pre-production phase. For the nine months ended October 31, 2004, cash provided from accounts payable and accrued liabilities was $20,000 compared to the $17.7 million source of cash for the nine months ended October 31, 2003. This change reflects the timing of payments of vendor invoices as well as an $11 million payment made during the second quarter of fiscal 2004 to EMC in connection with the ESCON service agreement amendment.

The decrease in net cash used by investing activities reflects the fiscal 2003 use of cash proceeds for the acquisitions of Nishan and Sanera and our equity investment in Aarohi. In addition, the use of cash also reflects the use of cash proceeds from the issuance of convertible subordinated notes to purchase investments in the nine months ended October 31, 2003.

Net cash used by financing activities during the nine months ended October 31, 2004 reflects the Company's purchase of treasury stock for $10.1 million. This use of cash is partially offset by proceeds from the issuance of common stock from stock option exercises and purchases under the Company's employee stock purchase plan. In February 2003, we issued convertible subordinated notes of $172.5 million in principal amount, with proceeds of $167 million. The 2.25% convertible subordinated notes mature in February 2010, unless converted into McDATA common stock at a conversion price of $10.71 per share, subject to certain conversion price adjustments. Offsetting these net proceeds in fiscal 2003 were the use of $20.5 million of those proceeds to enter into share option transactions and $5 million of cash being classified as restricted related to our interest rate swap agreement.

Off-Balance Sheet Arrangements

Other than facility and equipment leasing arrangements, the Company does not engage in off-balance sheet financing activities.

During its normal course of business, we may enter into agreements with, among others, customers, resellers, OEMs, systems integrators and distributors. These agreements typically require us to indemnify the other party against third party claims or product infringements on patents or copyrights. We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising for the use of our products. We have also indemnified our former parent, EMC, for any income taxes arising out of the distribution of our Class A common stock in February 2001. In addition, the majority of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential future payments we could be obligated to make. We evaluate and estimate losses from such indemnification under SFAS No. 5, Accounting for Contingencies, as interpreted by FASB Interpretation No. 45. To date, we have not incurred any material costs as a result of such obligations and have not accrued any liabilities related to such indemnification and guarantees in our financial statements.

Commitments

The Company has contracted with Sanmina SCI Systems, Inc. (SSCI), Solectron Corporation (Solectron) and others (collectively, Contract Manufacturers) for the manufacture of printed circuit boards and box build assembly and configuration for specific multi-protocol directors and switches. The agreements require the Company to submit purchasing forecasts and place orders sixty calendar days in advance of delivery. At October 31, 2004, the Company's commitment with the Contract Manufacturers for purchases over the next sixty days totaled $62.7 million. The Company may be liable for materials that the Contract Manufacturers purchase on McDATA's behalf if the Company's actual requirements do not meet or exceed its forecasts and those materials cannot be redirected to other uses. At October 31, 2004, the Company had recorded obligations of approximately $6.6 million (See Note 4) primarily related to materials purchased by the Contract Manufacturers for certain end-of-life and obsolete material. Management does not expect the remaining commitments under these agreements to have a material adverse effect on the Company's business, results of operations, financial position or cash flows.

In February 2003, the Company sold $172.5 million of 2.25% convertible subordinated notes due February 15, 2010 (the Notes). ... into our Class A common stock at conversion rate of 93.3986 shares per $1,000 principal amount of notes